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In the Supreme Court of the United States

No. 708

WHITE STAG MANUFACTURING COMPANY,

Petitioner-Appellant,

v.

DEAN ELLIS, F. H. W. HOEFKE and CHARLES MACK, members of and constituting the State Tax Commission of the State of Oregon,

Defendants-Appellees.

On Appeal from the Supreme Court of the State of Oregon

BRIEF OPPOSING MOTION TO DISMISS

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BRIEF OPPOSING MOTION TO DISMISS

DEFENDANTS' STATEMENT OF THE CASE

The defendant's statement of the case is too general and abstract to provide a fair and adequate basis upon which to determine whether the questions presented by the appeal are substantial. On pages 6 through 16 of the Jurisdictional Statement of facts are set forth which are essential to a proper understanding of the questions presented by the appeal, and thereafter facts are set forth and cases are cited that show that substantial federal questions are herein involved.

REPLY TO DEFENDANTS' CONTENTION THAT JURICDICTION SHOULD NOT BE INVOKED UNDER 28 U.S.C. § 1257(2)

The Motion to Dismiss seems to indicate a misconception of the contentions of plaintiff, one of which is that the Oregon three-factor formula as applied to plaintiff violates the federal constitution because the formula as so applied allocates to Oregon substantial income not earned in Oregon.

On page 3 of the Motion to Dismiss, defendants did not accurately summarize the allegations of plaintiff's complaint. Those allegations are correctly summarized on pages 14 and 15 of the Jurisdictional Statement and are quoted on pages 6 and 7 of the appellants' Abstract of Record and Brief filed in the Oregon Supreme Court, ten copies of which were filed in the office of the clerk of this Court.

The cases of *Rohr Aircraft Corp.* v. *County of San Diego et al.*, 362 U.S. 628, 80 S. Ct. 1050, and *Charleston Federal Savings & Loan Association* v. *Alderson*, 324 U.S. 182, 65 S. Ct. 624 cited by defendants do not

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[1] Where the word "pages" appears in the second sentence of paragraph XI of plaintiff's first cause of suit as copied on page 6 of the Appellant's Abstract filed in the Oregon Supreme Court, the words "wages and property" appear in corresponding paragraph IV in plaintiff's second cause of suit (page 8 of the complaint. This also appears in Appellant's Supplemental Abstract of Record, which is page 1 of Appellant's Reply Brief filed in the Supreme Court of Oregon, ten copies of which were filed with the clerk of this court. The complaint is set forth on pages 1 through 11 of the record filed in this court.

support defendants on the point for which they are cited, because in those cases the appellant did not timely insist that the state statute was repugnant to the federal constitution. In the instant case the validity of the Reg. 4.280(1)-(B) (formerly Reg. 7.180(1)-(B) was directly and expressly drawn in question in the Oregon court. In *Charleston Federal Savings & Loan Association* v. *Alderson*, supra, 185, the court said:

> "Where it appears from the opinion of the state court of last resort that a state statute was drawn in question, as repugnant to the Constitution, and the decision of the court was in favor of its validity, we have jurisdiction on appeal."

As pointed out on page 15 of the Jurisdictional Statement, plaintiff, in its brief filed in the Oregon Supreme Court, stated under its Points and Authorities that the Oregon regulation, providing for the formula, as applied to plaintiff, violates the provisions of the United States Constitution which are herein involved, and plaintiff argued the same in its brief filed in the Oregon Supreme Court (p. 43-44). That court ruled against the plaintiff on these contentions (Jur. St., A23). The Jurisdictional Statement shows that the validity of the regulation was drawn into question as being repugnant to the United States Constitution and that the decision of the Oregon Supreme Court was in favor of the validity of the regulation. Nevertheless, on page 4 of the Motion, defendants state that "Neither the Oregon circuit court nor the Oregon Supreme Court based its decision on the question of the validity of the statute in question, but rather on * * * nonfederal grounds * * *."

Defendants then quote from the opinion of the circuit court, but this appeal is from the decision of the Oregon Supreme Court, which upheld the validity of the regulation.

An allocation of a portion of plaintiff's net income to Oregon was made by defendants under the apportionment formula. The Oregon Supreme Court sustained that allocation over the plaintiff's contention that the regulation providing the allocation formula as applied to plaintiff violated the due process and equal protection clauses of the Fourteenth Amendment and the commerce clause of the United States Constitution. The Oregon Supreme Court had to decide that the regulation as applied to plaintiff did not violate these constitutional provisions in order to dispose of the case as it did. There is no ground upon which that court's decision could rest that is free of the question of the validity of the regulation.

Even if the Oregon Supreme Court had said nothing about the constitutional contentions of plaintiff, the upholding of the allocation would be equivalent to an express decision in favor of the validity of the regulation. *Dahnke-Walker Milling Co.* v. *Bondurant*, 257 U.S. 282, 289, 42 S.Ct. 106, 66 L.Ed. 239 (1921). But the Oregon Supreme Court did expressly rule against the plaintiff on its contentions that the regulation violated the Fourteenth Amendment and perhaps also in the commerce clause contention for it said:

> "The constitutional questions raised have several times before had the attention of this court and the federal courts where they have been resolved against plaintiff's contention." (Jur. St., A23)

On page 5 of the Motion to Dismiss, defendants quote a sentence from the opinion of the Oregon Supreme Court. Regardless of what that court said in the course of its opinion the fact remains that the formula in the regulation as applied to plaintiff taxed plaintiff on account of substantial income not earned in Oregon, and under the doctrine of *Hans Rees' Sons, Inc.* v. *State of North Carolina*, 283 U.S. 173, 51 S.Ct. 385, 75 L.Ed. 879 (1931) this violated the federal constitution. The fact that such income was so taxed is not denied or even mentioned in the Motion to Dismiss.

The cases of *Stembridge* v. *Georgia*, 343 U.S. 541, 72 S.Ct. 834, 96 L.Ed. 1130 and *Ellis* v. *Dickson et al.*, 349 U.S. 458, 75 S.Ct. 850, 99 L.Ed. 1231 are of no assistance to defendants. In the *Ellis* case the state court did not state the ground for its decision. In the *Stembridge* case the state court took no action upon the federal question. In the *Stembridge* case, p. 547, the United States Supreme Court held:

> "* * * Where the highest court of the state delivers no opinion and it appears that the judgment *might* have rested upon a nonfederal ground, this Court will not take jurisdiction to review the judgment * * *"

In the case at bar the Oregon Supreme Court delivered an opinion showing the federal questions were considered and decided adversely to plaintiff.

At the bottom of page 5 of the Motion, defendants state, in effect, that the objectionable feature of the regulation is the sentence therein which states that "Payments to bona fide independent contractors em-

ployed by a taxpayer are not included in the wage factor." That is an objectionable feature, but plaintiff does not confine its objection to Reg. 4.280(1)-(B) to that sentence. The questions presented on appeal are not limited to that sentence (Jur. St. 6), and on page 19 of the Jurisdictional Statement it is stated that the first question on page 6 presents two issues: 1) whether the regulation in its entirety, as applied to plaintiff, is unconstitutional, and 2) whether, aside from the constitutionality of the rest of the regulation, the sentence, as applied to plaintiff, is unconstitutional.

On page 24 of the Jurisdictional Statement it is stated that to best of plaintiff's knowledge the regulation was not in effect during the years in question, and that, therefore the question presented should be determined as if the sentence were not in the regulation. Page 43 of plaintiff's opening brief in the Oregon Supreme Court states that it is doubtful if Reg. 4.280 was published in time to apply to fiscal year 1957. The Oregon Supreme Court did not mention this in its opinion, and the first time defendants indicated that the regulation was not promulgated until January 20, 1959, was in the Motion to Dismiss this appeal. Aside from the fact that the sentence was not in the regulation replaced by Reg. 4.280(1)-(B), the two regulations are substantially the same. (Jur. St. A28-A35). The Oregon Supreme Court decided the case on the basis that Reg. 4.280(1)-(B) applied to each of the years in question.

Defendants cite *Manhattan General Equipment Co. v. Commissioner*, 297 U.S. 129, 56 S.Ct. 397, 80 L.Ed. 528. Prior to examining this case plaintiff was of the

opinion that if the sentence in question was not in the regulation prior to November 3, 1957, the instant case would have to be decided under the regulation as it existed prior to that date (Reg. 7.180(1)-(B); but the *Manhattan* case seems to raise a question with respect to this. If under the holding of the *Manhattan* case, Reg. 4.280(1)-(B) containing the sentence in question relates back to the time of the enactment of the statute, then this case must be determined on the basis of the sentence being in the regulation during both of the taxable years involved.

Regulation 4.280(1)-(B) is only a repromulgation of Regulation 7.180(1)-(B). If the sentence applies to the years involved, then it cannot be said that the sentence did not influence the state court, and from language in the opinion it would appear that the Court was definitely influenced by it (Jur. St. 20). Whether or not the sentence applies to the years involved, the fact remains that under the formula set forth in the regulation as applied to plaintiff, plaintiff's tax was measured by income, a substantial part of which was not earned in Oregon and because of this (and aside from the sentence) the regulation, as so applied, is repugnant to the constitutional provisions referred to in the questions presented by this appeal.

On page 6, defendants say that the opinion of the Oregon Supreme Court indicates that property and wages of third parties are not a part of plaintiff's business. In the first place plaintiff did not include any part of the fees paid third parties in the property factor of the formula, however, the second cause of suit al-

leges that a portion of such fees are actually rental payments. The plaintiff did include 70 per cent of the fees paid the third party in the wage factor, not only in the "everywhere" side, but in both sides. That percentage of the fees paid third parties in Oregon was put in the Oregon side and of those paid to third parties out of Oregon was put in the "everywhere" side of the wage factor. And, in the second cause of suit plaintiff proposed including a capitalized part of the fees as rent in both sides of the property factor (not just in the everywhere side as the Oregon Supreme Court assumed. Jur. St., A22).

Plaintiff included said 70 per cent of the fees paid the third party plants in the wage factor in order to accomplish an allocation to Oregon of a fair and equitable portion of plaintiff's income, namely the portion earned in Oregon. The Tax Commission required the inclusion of the wage factor of 50 per cent of the fees paid by a Washington Plywood plant to logging contractors in Oregon for logging the plant's Oregon timber. This was required because the commission thought that the standard formula did not reflect income earned in Oregon as the plant had no direct payroll in Oregon (Tr. of Testimony 80, 81). It was the knowledge of this requirement that caused plaintiff to include in the wage factor a portion of the fees it paid the third party plants for making garments for plaintiff out of plaintiff's materials (Tr. of Testimony 81).

While plaintiff objects to the defendants striking from the wage factor the 70 per cent of the fees paid by plaintiff to third party plants that defendant had included

therein, the most important point is that the formula as applied to plaintiff is unconstitutional because it allocated to Oregon substantial income not earned in Oregon and thereupon taxed plaintiff substantially more than it should have been taxed or that other corporations with the same Oregon income were or would be taxed. As applied, the formula unreasonably and arbitrarily overtaxed plaintiff in violation of the constitutional provisions herein involved.

The Oregon Supreme Court said nothing about "proprietory interest" with respect to the wage factor (Jur. St. A22). *Hines Lbr. Co.* v. *State Tax Commission*, 215 Ore. 453, 336 P.2d 75, is mentioned by defendants as being cited by the Oregon Supreme Court in connection with its statement concerning its proprietory interest in property. This case dealt with the question of whether the unamortized cost to taxpayer of roads built on land owned by the government or privately by third parties was includible in the property factor of the Oregon formula. The roads were owned and controlled by the government. They were used by the public as well as by the taxpayer. Under the circumstances the unamortized cost was held not includible in the property factor.

In the instant case the third party plants to the extent they were used to make garments for plaintiff were used exclusively for plaintiff. Their use for such purposes was an activity of plaintiff. Hence the *Hines* case and the instant case are distinguishable. Any general statement in the *Hines* case must, of course, be accepted in the light of the particular facts of that case.

II

SUBSTANTIAL QUESTION

A. Due Process

On page 7 of the Motion to Dismiss, defendants assert that the reason why plaintiff found no reported case with a factual situation comparable to that of the instant case was because plaintiff's contentions are frivolous and without merit. The merit or demerit of plaintiff's contentions has no bearing upon its ability to discover a case with a similar factual situation, and defendants did not undertake to show otherwise. Nor does plaintiff's inability to find a case comparable on the facts mean that its contentions are frivolous. It is not uncommon for cases to arise under factual situations which prior thereto had not been considered in a reported case. Differences in facts go to the very heart of the questions presented to courts for decision.

The Motion to Dismiss does not meet the point of the two corporation example given by plaintiff which is quoted on page 7 of the Motion. True, the tax rate and the net income are the same, but the part of the income allocated to the state is different, and the vice lies in this difference as is pointed out on pages 18 and 19 of the Jurisdictional Statement. On page 8, defendants say that the fallacy in plaintiff's said example is characterizing fees paid third parties as plaintiff's own act. It is plaintiff's contention that there is no economic difference between paying labor directly and paying it as a part of the fees paid the third party plants all as pointed

out on page 19 of the Jurisdictional Statement. Inasmuch as there is no such economic difference, there is no such fallacy.

Defendants cite *Butler Bros.* v. *McColgan*, 315 U.S. 501, 62 S.Ct. 701, 86 L.Ed. 991 as authority for their statement that "This Court has ruled the three factor formula as used by Oregon * * * a fair and reasonable way of allocating the income of a unitary business to the state." Plaintiff respectfully submits that the *Butler Bros.* case does not say what the defendants seem to think it says. In the *Butler Bros.* case the propriety of the use of the formula employed was not questioned if "a formula for allocation to California of a portion of appellant's income from all sources is proper." (p. 505). In the case at bar the use of the formula is questioned on the very grounds upon which the formula in *Hans Rees' Sons, Inc.* v. *North Carolina*, supra, was questioned.

In the *Butler Bros.* case, supra, the court did say that if the formula assigned to California that portion of net income reasonably attributable to business done there any constitutional question under the Fourteenth Amendment was at an end; but the court also said that one who attacks a formula has the burden of showing that it results in extra territorial values being taxed. The court then pointed out that that burden had been maintained in the *Hans Rees' Sons, Inc.* case, supra, but that no such showing had been made in the *Butler Bros.* case. The proof that was lacking in the *Butler Bros.* case is present in the case at bar and therein lies the distinction.

Defendants are mistaken when on page 8 of the Motion they say there is no discrimination between plaintiff and a wholly intrastate business. The facts show that the formula allocated substantially more income to Oregon than plaintiff earned in Oregon (Jur. St. 17). A corporation doing solely an intrastate business earning exactly the same net income that plaintiff earned in Oregon would pay 8 per cent of the net income to Oregon as excise tax, while plaintiff would pay at the same rate on amounts about 32.8 per cent and 47.3 per cent greater than it earned in Oregon. This is because the formula as applied to plaintiff allocates to Oregon about 32.8 per cent and 47.3 per cent more net income than it actually earned in Oregon during the fiscal years ended in 1956 and 1957 respectively.

Defendants say that *Royster Guano Co.* v. *Virginia*, 253 U.S. 412, 40 S.Ct. 560, 65 L.Ed. 989 is completely distinguishable, but they do not tell why. It is true that the taxing acts are different. The important thing, however, is that the Virginia statutes and the Oregon regulation brought about different tax consequences to domestic corporations not based on a difference in income. The Oregon regulation imposed just as much of an arbitrary discrimination as did the statute which was struck down in *Royster Guano* case.

On page 8, defendants say that the conclusion of plaintiff that Reg. 4.280(1)-(B) imposes a higher tax on plaintiff than it would impose on an Oregon corporation having the same Oregon income is without authority and contrary to judicial precedent. There is no authority or precedent that can change a pure mathematical fact.

The formula txaes 32.8 and 47.3 per cent more income than was earned in Oregon and nó case could possibly contradict this. These figures show the error in defendants' statement (p. 8) that the Oregon "measure reaches only income earned in Oregon."

No case cited at the end of page 8 of the Motion to Dismiss in anyway alters the fact that the Oregon formula is allocating to Oregon substantial income not earned in Oregón.

In *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, the evidence failed to establish that the amount of net income allocated to Connecticut was not reasonably attributable to the processes conducted within that state.

In *A. C. Dutton Lbr. Co.* v. *State Tax Commission*, 228 Or 525, 364 P.2d 867, there was no evidence that more taxes were exacted than should have been paid.

In *Edison California Stores* v. *McColgan*, 30 Cal. 2d 472, 183 P.2d 16, the court in effect held that the plaintiff had not shown that the formula was unreasonable (p. 483).

In *El Dorado Oil Works* v. *McColgan*, 34 Cal. 2d 731, 215 P.2d 4, app. dismissed 340 U.S. 801, 71 S.Ct. 52, it was held that the plaintiff had made no demonstration of unfairness in the application of defendant's reallocation formula (p. 744).

The evidence lacking in the cases last mentioned and in the *Butler Bros.* case, supra, preponderates in the case at bar.

The Jurisdictional Statement (p. 16-26) shows that the regulation is repugnant to the due process and equal protection of the laws clauses of the Fourteenth Amendment and nothing in the Motion to Dismiss overcomes this showing. In fact the defendant does not specifically contend that the regulation is not repugnant to the equal protection clause.

B. The Commerce Clause

Defendant endeavors to offset the strength and authority of the case *Hans Rees' Sons, Inc.* v. *State of North Carolina*, 283 U.S. 123, 51 S.Ct. 385, 75 L.Ed. 879, by pointing out that the formula in that case had one factor, while the Oregon formula has three; but as stated in the Jurisdictional Statement (p. 23) the important point in the case is that it condemns the allocation to a state of income out of all proportion to the business transacted in the state. This case teaches that though a formula is fair on its face, if its application to a particular taxpayer attributes income to him out of all proportion to the business done in the taxing state, the formula is repugnant to provisions of the United States Constitution. This is true whether the formula has one factor, three factors or any number of factors.

McGoldrick v. *Burwind White Co.*, 309 U.S. 33, 60 S.Ct. 388, 88 L.Ed. 565, concerns a city tax on sales of goods for consumption.

Memphis National Gas Co. v. *Stone*, 335 U.S. 30, 68 S.Ct. 1425, 92 L.Ed. 1832, involves a franchise or excise tax laid on the value of capital used, invested or employed in Mississippi.

Matson Navigation Co. v. *State Board*, 297 U.S. 441, 56 S.Ct. 553, 80 L.Ed. 791, is concerned with a California privilege tax measured on the portion of net income derived from business done within the state. In the opinion (p. 445) this Court said:

> "* * * No question of apportionment is here involved. * * *"

The fact that no such question was involved distinguishes the *Matson Navigation Co.* case from the instant case. The Oregon formula as applied to plaintiff included in the measure of the tax substantial net income not earned in Oregon.

The Oregon corporation's excise tax is imposed by ORS 317.070, which during the years herein involved provided:

> "Every mercantile, manufacturing and business corporation doing or authorized to do business within this state * * * shall annually pay to this state, for the privilege of carrying on or doing business by it within this state, an excise tax according to or measured by its net income, to be computed in the manner provided by this chapter, at the rate of * * * eight per cent * * *"

ORS 317.070 is subject to ORS 314.280 (formerly 317.180) or, in other words, "net income" as used in ORS 317.070 means net income earned in Oregon. In *A. C. Dutton Lbr. Corp.* v. *Tax Comm.*, 228 Or. 525, 534, 365 P.2d 867 (1961), the court said:

> "* * * The excise tax of this state is a tax measured by or according to net income earned in Oregon * * * It is imposed upon business corporations

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[1] The rate of 6 per cent used in the example on page 18 of the Jurisdictional Statement is the current rate, which has been in effect since 1957.

> for the privilege of carrying on or doing business in this state * * *"

Inasmuch as the Oregon corporation excise tax is imposed upon corporations for the privilege of doing business, then to the extent the excise taxes imposed on the plaintiff were measured by income earned out of Oregon in interstate commerce, the taxes imposed a burden on interstate commerce. As indicated on page 13 of the Jurisdictional Statement, this burden for the years in question exceeded $9,000.

On page 11 of the Motion, defendants cite *Bass, Ratcliff & Gretton, Ltd.* v. *State*, 266 U.S. 271, 45 S.Ct. 82, 69 L.Ed. 282 and again cite *Underwood Typewriter Co.* v. *Chamberlain*, supra. Evidence that out of state income was taxed was lacking in each of these cases. In *Hans Rees' Sons, Inc.* v. *State of North Carolina*, supra, 132, this Court pointed out the distinction between that case and the *Underwood* and *Bass* cases. It is the same distinction between the two cases last mentioned and the instant case. Nothing in the part of the opinion in the *Underwood* case quoted on pages 11 and 12 of the Motion is any more applicable to the case at bar, than it was to the *Hans Rees' Sons* case.

The quotation by defendants from the *Underwood* case contains the sentence:

> "Payment of the tax is not made a condition precedent to the right of the corporation to carry on business, including interstate business."

This sentence, no doubt, prompted defendants' statement on page 13 of the Motion that "Oregon's tax need

not be paid as a condition of doing business in Oregon; it places no bar on interstate operations and is collected through ordinary means." The cases cited in the *Underwood* case next following the sentence above quoted from that case were concerned with taxes measured on property within the state, not income earned outside the state. Apart from the implication contained in the sentence quoted from the *Underwood* case, there seems to be no requirement that payment of a tax be made a condition precedent to the right to carry on business before the tax can be considered as a burden on interstate commerce. Certainly no such requirement was made or discussed in the *Hans Rees' Sons* case, supra, in which the tax was found to be unconstitutional. The North Carolina statute made no such condition precedent and the Court concerned itself with assessment, not payment. So far as the provision with respect to payment of the tax is concerned, the Oregon statute (ORS 317.070) and the North Carolina statute are much the same.

In *Ford Motor Co.* v. *Beauchamp*, 308 U.S. 331, 60 S.Ct. 273, 84 L.Ed. 304, the statute is so different from the Oregon statute and regulation that the case throws no light on the questions involved in the instant case. In the *Ford Motor Co.* case, there is no claim that income not earned in the taxing state was used in the measure of the tax.

International Shoe Co. v. *Shartel*, 279 U.S. 429, 49 S.Ct. 380, 72 L.Ed. 781, is the last case cited by defendants. This case is of no aid to defendants. It does not involve the question of whether income earned out of the state was used in measuring a tax.

The difference between the case at bar and most of those relied upon by defendants is that the evidence in the instant case shows that substantial income not earned in Oregon was included in the measure of the tax, while in none of the other cases except in the *Hans Rees' Sons* case was this true.

On pages 12 and 13 of the Motion defendants say that not allowing plaintiff to include in the formula property owned or wages paid by independent contractors, could not raise the question of burdening interstate commerce nor a substantial federal question. This conclusion fails to take all the facts into account and is erroneous. Plaintiff sought to include in the allocation formula only that part of the fees paid third parties that represented wages; and in its second cause of suit, it alleged that an additional portion of the fees paid to third parties actually represented rental paid for the use of third party plants. These plants manufactured clothing for plaintiff out of plaintiff's materials in accordance with plaintiff's designs and specifications and under its general supervision. It is plaintiff's position that there is no economic difference between this procedure and making the goods in its own plants or in plants formly rented by it. The regulations permit the rent to be capitalized and included in the property factor (Jur. St. A31-33). Without the inclusion of about 70 per cent of the fees paid third parties in the formula, the formula allocates to Oregon more income than was earned in Oregon. But, this is only one aspect of the case.

Plaintiff also contends that the formula as applied to plaintiff caused income not earned in Oregon to be

allocated to Oregon and used by Oregon as a measure of a tax, that that in turn imposed in excess of $9000 more taxes (interest included) on plaintiff than should have been imposed or that would be imposed on other taxpayers with the same Oregon net income and that this violates the constitutional provisions herein involved. Under this aspect of the case, the inclusion or exclusion of a portion of the fees paid third parties is not involved. The contention is simply that as applied to plaintiff, the regulation containing the formula violated those constitutional provisions.

CONCLUSION

The conclusion in the Motion to Dismiss is erroneous. The regulation as applied to plaintiff has denied it equal protection of the law, has taken its property without due process of law and has imposed a burden on interstate commerce, and the appeal presents substantial federal questions. Therefore, plaintiff respectfully asks that defendants' Motion to Dismiss be overruled and that plenary consideration with briefs on the merits and oral argument be granted.

Respectfully submitted.

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